

General Information Letter: Replacement tax paid by trust, to the extent payment has reduced the taxable income distributed to beneficiaries, must be added back by the beneficiaries in computing base income.

March 23, 2000

Dear:

This is in response to your letter dated February 28, 2000, in which you request a letter ruling. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us.

In your letter you have stated the following:

Statement of Facts

Taxpayer is a resident Illinois complex trust filing a 1999 Form IL-1041. The trust has only one beneficiary, who is a nonresident of Illinois and has received a distribution of all the trust's distributable net income for 1999. The trust deducted an amount for Illinois income and replacement taxes paid on the trust's Federal 1041 for 1999, and this amount will be shown as an addition on Form IL-1041, Part I, Line 2b, Column B and on Schedule K-1-T, Line 31, Column A. The Illinois tax was due on the 1998 Form IL-1041 by reason of capital gains from the sale of stocks and bonds which were allocable to the fiduciary.

Statement of Issue

Is the Illinois addition for Illinois income and replacement tax deducted required to be included on Schedule K-1-T, Line 31, Column B as allocated to Illinois to the nonresident beneficiary?

We would appreciate it if you could provide a citation of any applicable authority for your position.

Response

The addition modification for Illinois income and replacement tax reported on Line 31, Column A, of the Schedule K-1-T must be allocated or apportioned to Illinois and reported in Column B to the same extent that the federal income tax deduction for such taxes was allocated or apportioned to Illinois.

Section 306 of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*) provides:

The items of income and deduction taken into account by an estate or trust in computing its base income for a taxable year shall be allocated or apportioned to this State to the extent provided by Sections 301 through 304 and, to the extent properly paid, credited or required to be distributed to beneficiaries for such taxable year, shall be deemed to have been so paid, credited or distributed pro rata.

Thus, any deduction for Illinois income or replacement taxes which was claimed by the trust in computing its distributable income is deemed to have been distributed to the beneficiary when the distributable income was paid out. Accordingly, Section 203(a)(2)(B) of the IITA, which requires any deduction claimed for tax imposed by the IITA to be added back in computing base income, requires the beneficiary to add back the deduction claimed by the trust for Illinois income and replacement taxes in the case you describe.

Section 307 of the IITA provides:

(a) Allocation of business income by beneficiaries other than residents. To the extent the business income of an estate or trust allocated or apportioned to this State in the possession of the estate or trust is deemed to have been paid, credited or distributed by the estate or trust under Section 306, the respective shares of beneficiaries of the estate or trust, other than residents, in such business income shall be taken into account by such beneficiaries in proportion to their respective shares of the distributable net income of the estate or trust for its taxable year and allocated to this State.

(b) Allocation of nonbusiness income by beneficiaries other than residents. To the extent items of estate or trust income and deduction not taken into account in computing the business income of an estate or trust are deemed to have been paid, credited or distributed by the estate or trust under Section 306, the respective shares of beneficiaries of the estate or trust, other than residents, in such items shall be taken into account by such beneficiaries in proportion to their respective shares of the distributable net income of the estate or trust for its taxable year, and allocated as if such items had been paid, incurred or accrued directly to such beneficiaries in their separate capacities.

Section 1501(a)1) of the IITA states:

The term "business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business, **net of the deductions allocable thereto**, and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. (emphasis added)

Thus, to the extent the deduction claimed by the trust is allocated to business income of the trust (that is, it reduced the net amount of business income apportionable to Illinois), it is an element of business income apportioned to Illinois under the same rules as items of gross business income. The reversal of this deduction in Section 203(a)(2)(B) of the IITA must similarly be apportioned to Illinois as an item of business income. Under Section 307(a) of the IITA, the beneficiary must apportion the deduction and the addition modification in the same manner.

With respect to nonbusiness income, Section 303(a) of the IITA provides the rules for allocating such income "together with any item of deduction directly allocable thereto." Thus, to the extent the federal income tax deduction claimed by the trust is allocated to nonbusiness income of the trust, it is allocated to Illinois in the same manner as the related income. The reversal of the deduction must be allocated in the same manner. Under Section 307(b) of the

IITA, the beneficiary receiving the distribution of nonbusiness income to which the deduction is attributed must allocate the deduction and the related addition modification in the same manner.

The net result, whether the federal deduction for the tax is attributed to business income or nonbusiness income, is that the deduction and the related addition modification are apportioned or allocated to Illinois in the same amount.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy Chief Counsel -- Income Tax